

California Department of Food and Agriculture:

**Improvement Is Needed in the Oversight
of Market Enforcement Activities**

July 1996
96102

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CALIFORNIA STATE AUDITOR

July 2, 1996

96102

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the California Department of Food and Agriculture Market Enforcement Branch's (branch) effectiveness in achieving its mission and objectives and fulfilling its regulatory responsibilities. This report concludes that the branch does not always pursue administrative, civil, or criminal action when it identifies violators of the code. Further, the branch is not always accurate or consistent in its calculations of settlement amounts for complaints. Finally, the Farm Products Trust Fund, which was established to provide payment protection to producers and licensees, does not provide adequate protection for claimants that have not received full compensation for farm products delivered to produce dealers or processors.

Respectfully submitted,

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Summary

Results in Brief




Audit Highlights ...

The Market Enforcement Branch does not consistently or effectively enforce fair marketing practices. In particular, the branch does not always:

- ✓ Call administrative hearings to revoke or suspend licenses.***
- ✓ Initiate appropriate administrative, civil, or criminal action against licensees violating the law.***
- ✓ Calculate settlement amounts correctly.***

Finally, the Farm Products Trust Fund does not provide adequate payment protection for claimants.



The Market Enforcement Branch (branch) of the California Department of Food and Agriculture (department) is responsible for regulating marketing practices for certain farm products in California. Its market enforcement activities, which are defined in Chapters 6, 7, and 7.5 of Division 20 of the Food and Agricultural Code (code), include licensing produce dealers and processors, investigating complaints against licensees and unlicensed operators of farm products, attempting to settle the issues between the parties involved in the complaints, taking punitive action against those who violate the provisions of the code, and administering the Farm Products Trust Fund (trust fund).

Our review of the effectiveness of the branch's enforcement activities indicated that, although it has recently made improvements, the branch does not enforce fair marketing practices consistently or effectively. We have the following specific concerns:

- The branch does not consistently call administrative hearings to revoke or suspend the licenses of processors or dealers that have violated the code's provisions. For example, although it identified 11 code violations by one licensee, the branch granted the renewal of the license and has not called an administrative hearing to address the possible revocation or suspension of the license.
- The branch does not always pursue administrative, civil, or criminal action against produce dealers when it learns, during complaint investigations, of their code violations. In our review of 44 complaint files, we found eight instances in which the branch noted but did not submit for prosecution such violations as dealers' withholding of brokerage fees from amounts due to producers without the producers' written consent, failure to provide a full or accurate account of sales as requested by producers, and failure to keep the transaction records required under the code. The branch also has not established regulations for determining when violations of the code are sufficient to warrant further action.

- The branch is not always accurate or consistent in its calculations of settlement amounts for complaints between producers and produce dealers. When settling a complicated complaint involving the calculation of settlement amounts, the branch can use extensive resources.
- When the branch is unable to effect settlements, it does not provide written notification to complainants that administrative hearings are available for consideration of licensing action against the respondents.
- For one settlement we reviewed, the branch inappropriately restricted its enforcement activities.
- Although the branch has taken steps to improve its Market Enforcement Licensing (MEL) automated system, the system still does not adequately serve the branch's needs. In particular, the MEL automated system cannot track the status of a license application and is not sufficiently integrated to allow all staff access to all complaint and investigation files.

Many of the problems with licensing and complaint activities arise from the lack of formal policies and procedures and the lack of training for the staff. Although the branch has developed policies, as of May 1996, the policies have not been approved. The branch's work is also made more difficult by certain poor business practices in the marketing of farm products, including the failure of producers to have written contracts that establish the terms of their marketing agreements with produce dealers.

We also found that the trust fund, which was established to provide payment protection to producers and licensees, does not provide adequate protection for claimants who have not received full compensation for farm products delivered to produce dealers or processors. Because of the trust fund's limited resources and the extensive procedures required before it can make payments, successful claimants against the resources of the trust fund received, on average, only 11 percent of amounts claimed and often waited a long time for payment.

Recommendations

To improve its license review activities, the branch should take the following steps:

- Establish and communicate to all licensing and investigative staff clear criteria for assessing new and renewal license applications. The criteria should identify conditions, including the nature and number of verified complaints and the important indicators of unsound financial condition, that would cause the branch to deny, suspend, revoke, or place on a probationary status any license application.
- Continue to implement changes to the controls and applications over the MEL automated system to allow a more efficient, effective use of its information.

To improve its complaint investigation and settlement activities, the branch should do the following:

- Establish and enforce clear regulations that identify the nature of processors' and produce dealers' behavior that would justify proceeding with criminal or civil remedies for violations of the code. Further, the branch should establish policies and procedures for staff to follow in calculating settlement amounts for complaints.
- Ensure that settlement agreements do not preclude the branch from carrying out its enforcement activities.
- Establish limits on the amount of resources it devotes to settling individual complaints. If it exhausts this limit on the resources without being able to assess all the transactions associated with the verified complaint, the branch should indicate clearly in its investigative report the status of the work and nature of the findings. This information should provide a sufficient basis for the complainant's decision to settle or pursue further action against the respondent. Further, the branch should consider proposing legislation that would limit the number of complaints it will investigate for a single complainant, especially if the complainant does not enter into written contracts with operators or fails to deal with licensed operators.
- Provide written notification to complainants that administrative hearings will be called if settlements cannot be reached.

To address the problem of the inadequate payment protection afforded by the trust fund, the branch should assess what changes in law or policy will most effectively and efficiently provide the greatest benefits to claimants and should submit a proposal for legislative change.

To improve the enforcement of action against violators of the code, the Legislature should amend the code to allow the department to assess and collect fines and penalties for code violations.

Agency Comments

The department agrees with the issues and information presented in our report and will address the recommendations we have made.

Introduction

Legislation enacted between 1928 and 1935 established the Market Enforcement Branch (branch) of the California Department of Food and Agriculture (department) and defined the primary role that the branch plays in regulating the marketing of farm products in California. Currently, the branch regulates the activities of all persons and businesses that purchase farm products other than milk, timber, and certain seeds for processing or resale.

The branch has as its primary mission the promotion of equitable marketing practices among producers, produce dealers, and processors of California farm products. To fulfill its mission, the branch has established goals to license all produce dealers and processors promptly and efficiently; to conduct audits, investigations, and settlements of complaints against produce dealers, processors, and unlicensed operators; and, when necessary, to apply corrective enforcement measures to ensure that produce dealers and processors of California farm products comply with legal requirements. In addition, the branch administers the Farm Products Trust Fund (trust fund), which was established to protect producers and licensees from the failure of licensees to pay for farm products delivered to them.

The Branch's Organization and Financing

The branch currently has 40 staff located in the Sacramento headquarters and its district offices in El Monte, Fresno, Sacramento, and San Francisco. The licensing staff processes initial and renewal license applications from produce dealers and processors, accounts for related licensing fees, administers the trust fund, and maintains and manages the branch's databases used by the licensing and investigative staff. The district office staff are investigators and auditors who investigate complaints, review license applications, and pursue the Food and Agricultural Code (code) violations alleged in complaint cases.

The budgeted expenditures for the branch for fiscal year 1995-96 were \$3.4 million, approximately 1.7 percent of the entire departmental budget. Licensing fees are the primary source of funding for branch operations.

Two advisory committees have assisted the branch in its work. The first, the permanent Market Enforcement Advisory Committee, was established by legislation in 1972 to advise the branch chief on policy and procedure issues. Its 13 members represent various agricultural product councils, farmers' groups, and other organizations involved in the California agricultural industry.

In October 1995, the secretary of the department established the temporary Market Enforcement Policy Review Committee (policy review committee) and appointed its 10 members. Assigned to review the mission of the market enforcement program and assess its effectiveness, the policy review committee submitted a final draft report of its findings and recommendations to the secretary in January 1996. The policy review committee's recommendations are extensive, covering both the licensing and complaint functions of the branch. As of May 1996, the department had supported legislation based on some of the report's recommendations for changes in the licensing practices but had not taken action on other recommendations in the report.

The Branch's Role in Licensing Produce Dealers and Processors and Their Agents

The licensing of produce dealers, processors, and their agents is one of the branch's primary functions. Licensing is intended to help maintain the orderliness of the agricultural markets by ensuring that successful applicants can meet their financial responsibilities to their business associates. Through the licensing process, the branch strives to regulate persons and businesses purchasing or handling California farm products.

For fiscal year 1995-96, the branch collected approximately \$3 million through April 1996 from the renewal or initial licensing of produce dealers, processors, and their agents. Approximately 64 percent of these funds are used to support branch operations, with 21 percent used for pesticide regulation and the remaining 15 percent for support of the trust fund.

The Branch's Role in the Complaint Process

Another primary function of the branch is to review complaints against produce dealers and processors of farm products, determine the validity of the complaints, and attempt to resolve verified complaints. The complaint process provides an alternative to civil action in courts of law and is intended to serve two main purposes. First, the process should save producers, produce dealers, and processors the high cost of legal fees that would be required to resolve disputes in the courts. In addition, effective complaint resolution should deter unfair business practices and foster the integrity of California agricultural markets. If the parties to a complaint do not agree to a settlement negotiated by the branch, the department will call an administrative hearing. When the responding business is financially unable to pay complainants all adjudicated costs, the complainant may receive compensation through the trust fund. As of December 1995, the branch had 617 open complaint files.

Scope and Methodology

The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct a comprehensive financial and performance audit of the branch.

To gain an understanding of the branch's responsibilities, we reviewed Division 20, Chapters 6, 7, and 7.5, of the code. In addition, we reviewed the branch's strategic plan; mission statement; organizational structure; notification efforts to producers; policies and procedures; and the training provided to its staff in the areas of accounting, auditing, and agricultural market practices.

To determine whether the branch licenses produce dealers and processors effectively, we reviewed 75 applications for licenses.

To ascertain whether the branch investigates complaints effectively, we reviewed 44 case files for complaints filed during fiscal years 1992-93 through 1995-96. We randomly selected 10 case files from each of the branch's four district offices. In addition, we selected 6 case files for investigations conducted by the Fresno district office that interested parties had brought to our attention. Under Rule 6(e) of the Federal Rules of Criminal Procedure, we were denied access by the federal government to 2 of the 6 case files. This rule prohibits disclosure to any party of the matters before a federal grand jury unless the party is

assisting a federal government attorney in the performance of the attorney's duties. In addition, the California Government Code and Evidence Code prohibit us from disclosing certain information related to investigations.

To determine whether the branch effectively enforces regulations governing violations identified during the investigative process, we reviewed the branch's method of addressing the violations identified in the case files discussed in the preceding paragraph.

To determine the position of the Attorney General, we interviewed and considered the comments of the Attorney General's staff assigned to work on the complaints for the branch.

To verify whether the branch is administering the trust fund in accordance with Chapter 7.5 of the code, we reviewed selected expenditures paid from the trust fund during the period of July 1994 through June 1995.

Further, to determine whether the internal controls designed to protect the branch's cash receipts, cash disbursements, and data processing were adequate, we reviewed internal audit reports and procedure manuals. We tested the internal controls for selected cash receipts and cash disbursements for branch operations that occurred during fiscal year 1995-96. We also examined the department's Market Enforcement Branch Program Review dated April 1995, and we determined whether the branch had implemented the information management recommendations cited in the report. This report was prepared by four employees from the Division of Marketing Services, with the assistance of a public policy consultant. Our review of the branch's internal controls for cash receipts and cash disbursements did not reveal material weaknesses.

Finally, to ascertain the agricultural industry's perception of the branch's effectiveness in exercising its policing powers, we conducted interviews with interested representatives for producers and produce dealers. In addition, we reviewed the draft report that the policy review committee submitted to the secretary of the department in January 1996.

Chapter 1

Licensing of Produce Dealers and Processors Needs Improvement

Chapter Summary

The Market Enforcement Branch (branch) of the California Department of Food and Agriculture (department) recently improved its licensing enforcement by establishing outreach procedures to notify produce dealers and processors about licensing requirements and by conducting audits of principal licensees to ensure that they are paying the correct annual license fees. However, the branch has several deficiencies in its licensing program. Specifically, the district office investigators who review license applications do not have adequate guidance or criteria for assisting the licensing staff in its decision to deny, revoke, or suspend licenses. As a result, the branch has not always enforced licensing requirements by denying new or renewal licenses to applicants. We also noted instances of procedural deficiencies in the license review process. Further, the control applications for the branch's Market Enforcement Licensing (MEL) automated system are inadequate. Finally, the branch allows the use of a waiver document that may violate the rights of a producer who consigns his farm product to a commission merchant for handling, sale, or resale.

Background

The Food and Agricultural Code (code), which requires licensing of produce dealers and processors, was enacted to address the extent and frequency of financial losses suffered by growers in the marketing of their farm products. Specifically, Division 20, Chapters 6 and 7, of the code requires the licensing of produce dealers; processors; and any person engaged in the business of buying, receiving on consignment, soliciting for sale on commission, or negotiating the sale of farm products from a licensee or producer for resale. Further, if the licensee employs any person as an agent, the agent is to be licensed in conjunction with the licensee.

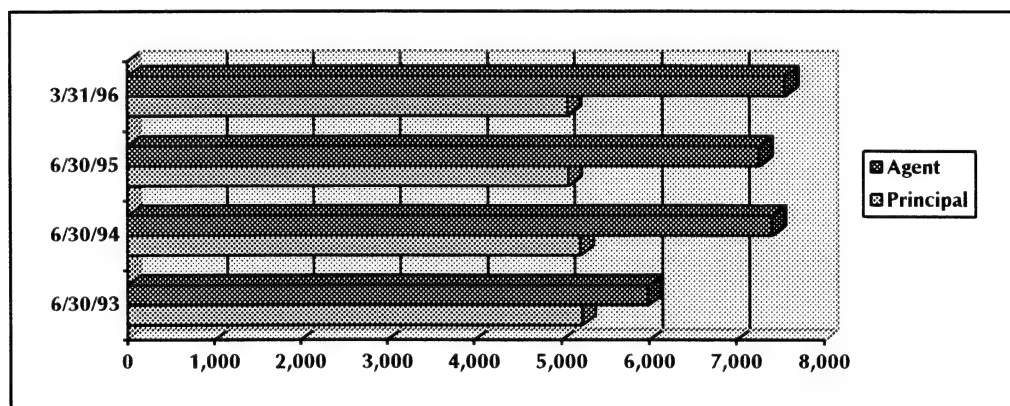
The branch issues over 12,000 licenses annually to produce dealers, processors, and their agents.

The secretary of the department has the authority to issue annual licenses to applicants who have demonstrated good character, responsibility, and good faith in conducting their business. The branch is responsible for reviewing initial and renewal applications to determine whether applicants have met these criteria.

The branch issues approximately 12,200 licenses to produce dealers, processors, and their agents annually. Figure 1 presents the number of active licenses that the department reports having on file for principal licensees and their agents as of the indicated points of time.

Figure 1

Number of Active Principal and Agent Licenses




Source: Market Enforcement Branch.

The branch assesses license fees based on the annual amounts that growers receive from the licensees for their products and collects the maximum license fees allowed by the code. For example, a licensee is assessed a fee ranging from \$100 for an annual dollar volume of less than \$20,000 to \$600 for an annual dollar volume of \$2 million and over. However, if the licensee applies for a conjunctive license, which applies to those persons or businesses operating as both produce dealers and processors, an additional fee, ranging from \$50 for an annual dollar volume of less than \$50,000 to \$200 for an annual dollar volume of \$2 million and over, is assessed. In addition, generally the licensee is assessed a food safety surcharge fee, which is 50 percent of the principal license fee, and a Farm Products Trust Fund (trust fund) fee of \$125 or \$250, if the licensee applies for a conjunctive license. The total fees paid by the licensees other than conjunctive license holders can range from \$275 to \$1,025. The principal licensee's agent,


who handles farm products on behalf of the licensee, is assessed a fee of \$35. The food safety surcharge fee and the trust fund fee are transferred to the Department of Pesticide Regulation and the trust fund, respectively. The remaining license fees, representing approximately 97 percent of the branch's revenues, pay its salaries, rent, utilities, and overhead expenses.

The Branch Recently Improved Its Licensing Enforcement

The branch recently improved its licensing enforcement practices; specifically, in 1994, it began efforts to identify potential principal licensees and notify them of the licensing requirements in Division 20, Chapters 6 and 7, of the code. The code requires all produce dealers and processors who handle farm products to be licensed.




Recent improvements include conducting informational meetings to discuss licensing requirements and steps producers can take to protect their interests in farm products transactions.




To accomplish its goal of enhancing licensing practices, the branch had display booths at the annual farm shows in Tulare, Colusa, and San Joaquin counties and at the California Farm Conference. In addition, the branch conducted informational meetings in Tulare, Fresno, and Merced counties. During the meetings, the branch also provided producers with information on pertinent topics, including how to protect their own interests in farm products transactions, how to file a complaint, and how to avoid the most common commission merchant violations. The branch introduced producers to its monthly "Market Enforcement Advisory on New Complaints Against Handlers and Processors," an advisory that identifies licensees for which the branch received verified complaints during the month.

In August 1993, the branch began conducting audits of principal licensees. Further, effective March 1996, each district office is required by the branch to conduct ten audits every month. However, despite this improved requirement, the branch will need approximately ten years to audit all persons or businesses currently licensed.

During audits, the branch randomly selects principal licensees and appears at their places of business requesting to review their financial statements to determine whether they correctly stated their annual volume of business on their applications. In addition, the licensing staff identifies those licensees whose renewal applications indicate a reduction in the license volume category from the previous year and submits this information to the appropriate district office for audit. These audits have



A 1993 branch policy resulted in nearly \$129,000 in additional license fee and penalty collections.



recovered approximately \$128,750 in additional licensee fees and penalties during the period of August 1993 through December 31, 1995.

Finally, if during its investigation of a complaint the branch determines that a produce dealer or processor is operating without a license, the business is required to satisfy any debt to the complainants and become licensed, paying double the licensee fees that would normally be required.

***Branch Investigators Need
Specific Criteria To Assist
in the Licensing Process***

Although the branch has established some policies and procedures for licensing, it has not provided adequate guidance to investigators who help assess whether applicants meet the criteria for licensing. As a result, licensing errors have occurred. We discuss examples of these errors beginning on page 9.

In determining whether an applicant has good character, the branch reviews applications for evidence of violations of the code, revocations or suspensions, felonies, or payments from the trust fund. Before issuing a license, the branch also searches its complaint databases to determine whether complaints have been filed against applicants. Further, it reviews its trust fund actions to determine whether the applicant had claims paid from the fund. Producers and licensees can file claims with the trust fund for partial compensation for their losses resulting from the failure of licensed produce dealers and processors to pay for farm products. In some instances, applicants are required to file financial statements, and the branch reviews them to determine whether they indicate an unsound financial condition, such as delinquent accounts payable or deficit net worth.

The branch staff exercises its judgment, on a case-by-case basis, to determine whether the branch should grant or deny an application. Specifically, if there exist open or closed complaints against a renewal applicant, the district office investigators inform the licensing staff about the status of the case and their recommendation for the renewal of the license. Further, the district offices notify headquarters as to whether the applicant is financially sound.

Without thorough guidelines to provide consistency, branch staff exercise their own judgment in licensing decisions.

However, although the investigator's manual, which the branch prepared for guidance in licensing and other activities, furnishes an overview of the licensing process, it does not provide specific criteria, such as the nature and number of verified complaints, for determining whether the branch should deny or approve an application. In the absence of specific criteria, each of the branch's 24 investigators exercises his or her own judgment when providing recommendations to accept or deny renewal applications, resulting in errors in judgment.

The Branch Should Improve Its Licensing Practices

In our review of license applications, we found examples of errors that can result from a lack of adequate guidance. Our review of 75 applications for licenses indicates that in three instances, the branch either did not exercise due diligence in its decision to issue licenses or failed to assess penalties for persons or businesses who were operating without a license. We also identified 24 instances of minor licensing compliance violations.


In one example of its failure to exercise due diligence, if the branch had taken appropriate action on a license renewal application in July 1994, two additional verified complaints may not have arisen. Specifically, the branch received, in March 1994, a verified complaint against a licensee that indicated a failure to pay for farm products worth approximately \$353,000. At the same time, under the Director's Own Motion, a provision of the code that gives the secretary of the department authority to investigate injurious transactions, the branch opened an investigative file and was able to identify 11 additional producers of farm products who were owed an additional \$697,000 by the processor. Between July 1994 and November 1994, the processor settled the verified complaints with the 12 producers, and the branch subsequently closed the complaint file.

If the branch had revoked or suspended the license of a processor with fiscal difficulties, subsequent complaints may not have arisen.


Our review of the investigative file indicated that the financial statements provided by the processor to the district office in June 1994 showed a deficit net worth of \$526,608, evidence of unsound financial condition. The branch stated that because the farm products handled by the processor were not harvested until late September through early November 1994, and the processor would not be making any purchases until September 1994, the licensee had time to get his financial condition in order and his line of credit established, so taking

any license action on the July 1994 license renewal would have been premature. However, the branch failed to review the processor's financial condition before the new harvest season.

The code states that evidence of an unsound financial condition is sufficient grounds for nonrenewal of a license; however, because the branch considered any licensing action on the July 1994 license renewal to be premature, it did not call an administrative hearing. In May 1995, the branch received two additional verified complaints against the licensee that alleged failure to pay for farm products and to render a true account of sales. Further, despite the licensee's history of financial difficulties, the branch renewed his license again on September 15, 1995, and as of May 1996 had not called an administrative hearing on the case. The branch states that it has been requested by the U.S. Attorney to hold any administrative action in this case.



Despite failing to pay over \$100,000 to producers, the branch allowed a licensee to continue in business under his wife's name.




In a second example of the branch's failure to exercise due diligence, we noted that in July 1992, a licensee did not renew his license and the branch stated that he was out of business. However, also in July 1992, his wife applied for a license using the same name and address of the company for which her husband was previously licensed. The branch issued the wife a license, justifying its action by stating that there had been a change of entity. Further, the branch issued an agent's license for the husband in conjunction with the wife's principal license that allows him to contract for farm products from producers on his wife's behalf. In September 1992, a verified complaint was filed against the husband as licensee, alleging failure to pay for farm products worth approximately \$101,000. The branch should have denied the subsequent renewals of the agent's license under Section 56133.5(a)(3), which states that a principal licensee cannot employ an agent who failed to pay producer claims for which the agent was liable.

The initial and subsequent license renewals for the wife conflict with an appellate court ruling. Specifically, in 1940, a similar case was presented to the Director of Agriculture, and the wife's license application was denied. The wife filed a peremptory writ of mandate issue requiring the Director of Agriculture to issue the license. The California Appellate Court in *Moseian vs. Parker* made the following ruling:


The purpose of the provisions of the Agricultural Code was primarily for the protection of the producers or growers of agricultural commodities, and to be sure that such producers shall be paid for their products by the dealer and broker. The statute is particularly concerned with the financial

standing and management, and where such control and management of the funds and property are in the hands of the husband as here indicated, it would be an absurdity to grant such a license to the wife when the same had been denied the husband because of his failure to make such payment to producers.

In our example, because the branch granted the agent's license, the husband was allowed to continue managing the funds and property of the same company for which he was previously licensed and failed to pay a producer of farm products. Despite the legal precedent to the contrary, the branch issued the wife's license.



The branch did not assess penalty fees to a business knowingly operating without a license.



We also noted an instance in which the branch did not comply with its procedures of assessing double licensing fees for produce dealers or processors discovered operating without a license. In September 1995, the branch received a new license application. Because the application was incomplete, the branch requested additional information from the applicant, and the license was not issued. In December 1995, the branch received a complaint against the applicant that indicated a failure to pay for farm products during September and October 1995. The complaint gave a clear indication that the applicant was engaging in activity requiring a license. The applicant made payment to the complainant and was issued a license in January 1996. In issuing the license, the branch, having the knowledge that the applicant was operating in a manner that required a license, failed to collect the double fees in the amount of \$625, as required by Section 56573.5 of the code. The branch justified its action based on a policy implemented in May 1990, which allowed an administrative grace period of 30 days for unlicensed operators who were not aware of the licensing requirements before double fees would be assessed. We question the branch's implementation of such a policy when the code requires it to assess double fees for any person operating a business without a license and especially when it is clear the applicant is aware of the licensing requirements.

In addition to the cases cited above, we observed these procedural deficiencies:

- Two instances in which the branch obtained required itemized statements that were partially completed. The code, Section 56271(f), requires commission merchants to submit with their application an itemized statement of charges to be paid by the consignor in connection with the sale.

- Nineteen instances in which the branch failed to obtain copies of required fictitious business name statements. The investigator's manual states that all applications must have the complete name of the applicant. For those applicants with a fictitious or "doing business as" name, a copy of the fictitious business name statement filed with the appropriate county should be attached to the application.
- Two instances in which the branch failed to obtain the applicant's signature.
- One instance in which the branch failed to collect \$350, an amount that represented a portion of the double fees assessed.

***The Market Enforcement License
Automated System Provides Only
Minimal Assistance to Branch Staff***

Lacking adequate controls and integration of databases, the branch's automated licensing system is inefficient and ineffective.

In our review of the controls and applications for the branch's MEL automated system, a database comprised of multiple files containing information from license applications and complaint memoranda, we found numerous significant problems. In April 1995, the Market Enforcement Branch Program Review, prepared by four employees from the Division of Marketing Services and a public policy consultant, concluded that the branch does not use its data processing system to its fullest potential.

The branch is aware of the need to improve its information system and has begun addressing the deficiencies noted in the review. In January 1996, it hired an associate information system analyst who is revising the MEL automated system. However, as of May 1996, the following conditions noted in the review had not been corrected:

- The MEL automated system lacks adequate control procedures and system documentation, and it provides only minimal checks to ensure the integrity of the data.
- The MEL automated system, which is used to issue licenses, does not monitor the status of an application from the time it arrives in the branch until the license is either issued or denied. For example, we noted six instances in which an application was classified as pending decision and the branch failed to apply or refund the license fees until at least four months after its decision was made.

- In addition, new information entered into the MEL automated system overrides existing information. As a result, historical licensing information is unavailable.
- Finally, the MEL automated system is not integrated with the three databases that the branch uses to monitor the status of complaints filed against applicants.

Until the branch fully addresses these conditions, its operations will be less efficient and effective than they should be.

Waivers Recommended May Violate the Consignor's Rights

Consignor's rights include affixing lot numbers to containers and notification of downward price adjustments.

The branch uses the licensing process to remind commission merchants of their responsibility to notify producers of their rights. Specifically, the branch publishes the Notice of Commission Merchant Requirements and provides this notice to the commission merchants with their new or renewed licenses. Included in the notice is a sample form designed to assist the commission merchant's notification process to his or her consignors. However, during our audit, it came to our attention that this sample form contains sections that may be in violation of the consignor's rights.

Recently, the legislative counsel stated that a commission merchant may not request a consignor to do the following:

- Waive his or her right to request lot numbers to be affixed on each individual farm product container as provided in Sections 56271(h) and 56281 of the code; or
- Waive his or her right to receive notice of a downward price adjustment or a reduction in quantity of farm products delivered.

According to the legislative counsel's opinion, the branch appears to recommend use of a document that violates the rights of the consignors to request lot numbers to be affixed on each farm product container and to receive notice of a downward price adjustment or a reduction in quantity of farm products delivered. The lot numbers are important tools in tracking and keeping separate records of the farm products of an individual producer as they are stored, shipped, and sold.

The branch acknowledges the legislative counsel's opinion, and it states that it will take this legal issue into consideration. However, as of May 1996, the branch had not obtained an opinion from the Attorney General to clarify the matter.

Conclusion

The branch has improved licensing enforcement by attempting to identify unlicensed operators and by auditing produce dealers and processors to ensure they have paid the appropriate license fees. However, the branch has deficiencies in its licensing activities. For the 75 applications that we reviewed, we noted three instances in which the branch either did not exercise due diligence in its decision to issue licenses or failed to assess penalties for operating without a license. We also noted several instances of procedural deficiencies in the license review process. In addition, the branch's MEL automated system lacks adequate controls and does not meet the branch's needs. Finally, the branch allows the use of a waiver document that may violate the rights of the consignors.

Recommendations

To improve its license review and enforcement activities, the branch should do the following:

- Establish and communicate to all licensing and investigative staff clear criteria to use in assessing new and renewal license applications. The criteria should identify conditions, including the nature and number of verified complaints and the important indicators of unsound financial condition, that require the branch to take administrative action to deny, suspend, revoke, or place on a probationary status any license application.
- Ensure that the sample waiver notification that the branch provides to commission merchants complies with all legal provisions and requirements.
- Clarify within its policies and procedures governing change of entity that a change of business ownership from one family member to another does not constitute a change of entity.

- Continue to implement changes to the controls and applications for the MEL automated system, especially those changes that would improve data integrity and allow for a more efficient and effective use of the information in the system during the licensing and complaint processes.
- Continue its efforts to identify unlicensed operators and principal licensees who have not paid the appropriate licensing fees and eliminate the administrative grace period allowed to unlicensed operators who are unaware of the licensing requirements.

Chapter 2

Inconsistent Complaint Handling and Enforcement Efforts Cause Problems


Chapter Summary

When investigating complaints of unfair marketing practices and attempting to effect a settlement between the complainant and the respondent, the Market Enforcement Branch (branch) is often successful in its attempts to reach a settlement agreement between the parties to the complaint. However, it does not always calculate settlement amounts accurately or consistently, primarily because investigators and audit staff lack training and policies and procedures for calculating settlement amounts. In addition, when settling a complicated complaint involving calculation of settlement amounts, the branch can use extensive time and resources. Finally, one settlement agreement we reviewed inappropriately restricted the branch's enforcement activities.


The branch also does not consistently take punitive action or initiate civil or criminal action against produce dealers or processors who have violated the California Food and Agricultural Code (code). When it is unable to negotiate settlement agreements, the branch does not have a policy of providing written notification to complainants that an administrative hearing will be called, nor does it take interim corrective action against respondents when administrative hearings are delayed.

The Department's Complaint and Enforcement Process

The secretary of the California Department of Food and Agriculture (department) may receive verified complaints from producers or individuals who, in accordance with the code, are licensed as produce dealers or processors. If the secretary receives a verified complaint from a producer or licensee who has failed to obtain satisfactory settlement of a transaction, the code requires her to effect a settlement between the complainant and respondent. The respondent may be a produce dealer, processor, or unlicensed operator. In addition, the secretary may on her own motion, or upon the verified



If the secretary of the department cannot effect a settlement, she must call an administrative hearing.




complaint of an interested party, conduct an investigation of injurious transactions. Examples of injurious transactions include those in which unlicensed individuals solicit or sell farm products while acting as produce dealers or processors or in which licensees have falsely stated market conditions.


If the secretary fails to effect a settlement that is satisfactory to both parties, she must call an administrative hearing. At the conclusion of the hearing, based on the recommendations of the hearing officer, the secretary will dismiss the complaint, include an order to suspend or revoke the license of the respondent, or affix conditional and probationary orders. Further, if the respondent violated Chapters 6 or 7 of Division 20 of the code, the secretary may initiate either criminal or civil penalties and remedies with the proper authorities.

To fulfill these requirements, the secretary has delegated the responsibility for handling complaints to the branch. The branch obtains the factual information from the complainant and prepares the preliminary complaint form. If the information filed by the complainant is sufficient, the branch is required to open a verified complaint, which is a notarized document signed by the complainant describing the nature of the complaint and the parties involved. The branch will then assign an investigator to determine if violations of the code have occurred. In cases involving complicated consignment transactions, the branch will assign either a senior investigator or an auditor.



Within ten days, the investigator will contact the respondent either in writing or in person to advise that individual or business that a complaint has been filed. The branch then gives the respondent an opportunity to respond to the verified complaint. If the respondent agrees with the amount alleged by the complainant, the investigator arranges for the respondent's payment to the complainant. However, if the respondent disagrees with the amount alleged by the complainant and refuses to settle, the branch's policy is to continue its investigation to determine a settlement amount, if any.



Poor business practices in the agricultural industry can make complaint resolution difficult.



Poor business practices in the agricultural industry can make resolution of these complaints difficult. For example, produce dealers do not always maintain adequate records to support their accounts of sales. In addition, producers do not consistently enter into formal, written contracts with produce dealers and processors that establish the terms of their agreements. Further, producers may fail to ensure that they deal only with licensed produce dealers and processors. When complaints arise in such cases, the branch must try to assist in


When records of transactions are incomplete, the branch attempts to reconstruct them using documents provided by other parties.


the settlement of complaints when insufficient records exist and when complainants and respondents have not taken adequate steps to protect their own interests.

In determining the settlement amount, the branch reviews the records maintained by the respondent that support the transactions identified in the verified complaint. If the respondent's records either are inadequate or do not support the transactions, the branch cites the respondent for failure to render a true account of sales. Using other sources, the branch will then attempt to reconstruct the transactions. For example, in one instance, the branch used the truckers' hauling receipts, accounts of sale from the receivers of farm products, letters from receivers regarding the quality of the farm products received, market news shipping point reports, and memorandums of sale from brokers. Further, it contacted the U.S. Department of Agriculture (USDA) to verify the authenticity of inspection reports received from the respondent that did not contain the USDA seal.


If either the complainant or the respondent disagrees with the settlement amount determined by the branch, the code requires the branch to proceed with an administrative hearing on the evidence regarding the complaint as presented by the parties involved.

Although the Branch Handles Certain Cases Appropriately, It Does Not Always Calculate Settlement Amounts Correctly


In general, the branch appropriately handles complaints that do not involve the calculation of settlement amounts. These are often complaints in which the parties reach a settlement after the branch's notification to the respondent of the verified complaint, resulting in its closure. For other complaints, when the unsound financial condition of the respondent is established, the branch appropriately initiates action on behalf of the complainants to recover part of the amounts due them through the Farm Products Trust Fund or notifies complainants of the availability of trust fund moneys. In each of these cases, the branch provides an important service to members of the agricultural community.

However, for complaints in which settlements are in dispute, the branch's work is more difficult, and it does not always appropriately calculate the settlement amounts. We reviewed 44 complaint cases and noted that, for 10 of the cases, the branch reconstructed the transactions in its attempt

to effect settlements. In 5 of the 10 cases, the branch did not document its method for calculating, did not obtain sufficient documentation to support costs allowed, calculated the amount incorrectly, or was inconsistent in the methodology used to calculate the settlement amount. These complaints involve transactions with commission merchants, who receive farm products on consignment.




In calculating one settlement amount, the branch incorrectly computed interest owed to the producer.




In one case, the branch calculated the settlement amount incorrectly. As part of each settlement, the branch determines whether there is an amount due to the complainant from the respondent. If so, the complainant has the option to collect interest on the amount owed. The branch calculated the interest using the period from the date it received the complaint to the date it began work on the case (4 months) instead of the total period of delinquency (21 months), as required by the code. In addition, in determining the price for farm products not supported by an account of sales, the investigator used a price for a similar transaction that was shipped 11 days before the disputed farm products were shipped. The branch's procedure to assess the reasonableness of unsupported prices is to compare them to the commission merchant's free-on-board prices for the same shipping date. If there are insufficient free-on-board sales, investigators are to make comparisons to shipping point prices reflected in the California Market News report. Because the investigator did not use similar transactions for the same day, an indication that they did not exist, he or she should have used the California Market News report. Further, the branch failed to disallow brokerage fees that had not been authorized by the producer. These errors, combined with others we observed, resulted in \$3,000 being owed to the producer in addition to the \$250 proposed by the branch.


In a second case in which the branch again calculated the settlement amount incorrectly, we found that the branch allowed downward price adjustments for farm products based on inspection certificates that indicated the inferior quality of the farm product but that did not contain the producer's grower or lot number as is required by Section 56271(h) of the code. Lot numbers identify the specific producer's crop that was inspected by the USDA inspectors. At the end of the examination of the respondent's records, the branch justified the downward price adjustment without the lot number by stating that the commission merchant handled the farm product from only one grower during the period of dispute. Further, because it was able to trace to the inspection certificates other identifying information, such as shipper's name, description of farm product, quantity, or the carrier's identification numbers, the branch concluded that the inspection certificates supported the downward price adjustment. However, during




The branch allowed downward price adjustments without adequate supporting documentation.



our audit, we conducted a site visit to the commission merchant's place of business and determined that the commission merchant handled farm products for more than one grower during the period of dispute. Further, Section 56280(b) does not allow charges against a consignor's account for downward price adjustments unless the commission merchant has a federal-state inspection certificate indicating the type and the extent of the substandard condition of the lot involved. In addition, Section 56280(f) requires the lot (farm product) to be identified as outlined by Section 56271(h). Therefore, the inspection certificates without the producer's grower or lot number did not provide sufficient support for the branch's conclusion. The branch's failure to disallow downward price adjustments resulted in approximately \$5,900 owed to the producer for 5 of the 15 items that we tested, in addition to the \$16,600 proposed by the branch:



In one case, errors, omissions, and changes in methodologies caused the branch to modify its settlement calculation four times.



In a case that demonstrates the branch's inconsistency in the methodology it uses to calculate settlement amounts, we found that the branch changed its settlement calculation four times. The first change came between the branch's initial presentation to the producer in September 1994 and the administrative hearing held in November 1995. Further, because of information provided in testimony in the administrative hearing, the branch recalculated the amount again in March 1996. The changes resulted from the branch's detection of errors and omissions and from changes in its methodologies. Specifically, the branch used the lower range of the price quoted in the Los Angeles Wholesale Market News report (less 20 percent commission) to determine the reasonableness of the price paid to the producer for some of the farm products that were not supported by an account of sales; however, as a result of a change in its policy, the branch recalculated the price using the average market price instead of the lower range of the market price. Further, the branch initially calculated the commissions to the commission merchant based on net sales and subsequently changed the methodology to gross sales. The branch does not have a policy that addresses the calculation of commissions. The net result of these changes increased the amount due to the grower, before the deduction of advances, from approximately \$33,000 to \$39,200, or \$6,200.

In yet another illustration of the branch's fluctuations in its settlement calculation, the investigator allowed downward price adjustments when the commission merchant had obtained only an unsigned inspection certificate to support his claim that the farm product was dumped. The code requires a dump certificate for the downward price adjustment. The branch subsequently changed its position and disallowed the downward price adjustment because the commission merchant had not

obtained a dump certificate. However, the branch did not correct its error until after the complainant rejected its initial settlement calculation and the branch began preparations for the administrative hearing. If the complainant had accepted the original settlement amount, there would have been no reason to reexamine the calculation and correct the error.

Without accurate and well-documented calculations of settlement amounts, the branch cannot ensure that settlement agreements are fair to the parties involved.

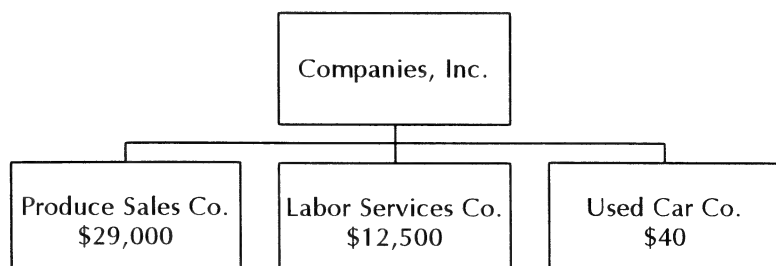
The Branch Did Not Deduct Advances Appropriately

In calculating a settlement amount, the branch deducted advances to the producer that were not clearly related to the crop in dispute.

We reviewed one case in which we determined that the branch exceeded its authority when, without written authorization, it deducted advances from the proceeds of the crop identified in the verified complaint. Our review of the advances indicated that, of the approximately \$42,000 in advances, less than \$3,450 was clearly related to this particular crop. Specifically, the producer and the produce dealer entered into an oral agreement for cash advances to be made related to harvesting the crop in dispute, to planting and maintaining other crops grown by the producer, and to paying the producer's personal expenses. In doing so, the produce dealer's produce sales, labor service, and used car companies made loans to the producer to pay for labor and various costs incurred to plant, maintain, and harvest all the crops. Because the loans came from different companies owned by the produce dealer and the costs cover other crops not identified in the verified complaint, the branch should have deducted only the advances related to the crop in the verified complaint. The producer and produce dealer could have settled the issue of the remaining advances in civil court. Figure 2 depicts the produce dealer's companies and the amount each advanced to the producer.

Figure 2

Produce Dealer's Companies



It is the branch's position that in providing financing to growers to permit them to bring their crops to market, commission merchants furnish a service comparable to their precooling, packing, palletizing, selling, and shipping services. Further, the branch states that because the producer never alleged that the produce dealer improperly deducted advances from his returns, no further action was required to determine the reasonableness of the advances. Therefore, it should be allowed to deduct these advances in the same manner as it is allowed to do so for the physical handling and marketing of the product. According to the Attorney General, deductions for advances are permitted in many situations. However, it has not formally specified that this situation is one of them.



We consider such situations to be appropriate when there are written agreements, such as promissory notes secured by a first deed of trust and security interest in crops grown or a Uniform Commercial Code 1 financing statement, which authorize the deduction of the advances and other expenses from the producer's proceeds. In the absence of a written agreement between the producer and produce dealer, the branch functions as a collection agency for the produce dealer instead of allowing the unrelated amounts to be addressed in civil court.

***Insufficient Training and a Lack
of Policies and Procedures
Have Created Problems***

The audit and investigative staff's lack of training and insufficient policies and procedures are major causes of the branch's problems in calculating settlement amounts.

Of the 26 staff who handle complaints, only 2 are auditors. Within the branch, the auditor's role is to conduct audits of the larger, more complex and sophisticated firms engaged in marketing and processing agricultural products. In addition, a branch auditor is responsible for writing the audit reports on the civil, criminal, and administrative actions that are sensitive and complex. Finally, the auditor is to train field investigators in auditing procedures. In 1994, the branch conducted a cost-benefit analysis of its audit unit and, as a result, reduced its audit staff from 5 to 2.



The deficiencies noted in three cases discussed above relate to complex consignment transactions between the producer and the commission merchant. Because it reduced the audit staff, the branch assigned field investigators to resolve some of these complaints.


Only 4 of 26 investigators and auditors have had accounting or auditing classes.


We obtained profiles for each investigator and auditor, outlining the training that each has received since beginning his or her employment with the branch, to determine whether the branch had provided adequate training to staff in the areas of accounting, auditing, and the marketing practices of the agricultural industry. Our review of the profiles indicated that the branch had not provided or required training in these areas. Specifically, we noted that although the investigators and auditors took numerous courses to enhance their investigative and interpersonal skills, only 4 of the branch's 26 investigators and auditors were identified in the profiles as having taken accounting or auditing classes. Of the 4, 1 individual participated in these classes as recently as 1995; however, another individual participated in these classes during the period of 1962 through 1964 without any additional training since that time. There was no indication that any of the investigators or auditors had participated in classes to educate them about the current marketing practices of the agricultural industry.

Further, we found that 9 investigators, or 35 percent of the investigative staff, have less than five years of experience with the branch. The lack of experience and of technical training in resolving complaints related to consignment transactions can have a direct effect on the quality of the work performed.

Finally, before 1995, the branch did not provide its staff with formalized policies or procedures to handle the verified complaints filed by the producers and licensees. In 1993, the department appointed a new branch chief, who, between July 1995 and March 1996, drafted 24 policies to assist its staff. However, to date, the branch has not formally adopted the policies. According to the branch chief, the policies are still being reviewed as to form and content.




Although the branch has prepared an investigator's manual, it has not provided guidelines on specific procedures essential to investigative work.


In 1995, the branch distributed to its investigators and auditors the finalized Market Enforcement Branch Investigator's Manual (investigator's manual). Despite the length of time that the branch has existed, before this time a manual had not been developed. The investigator's manual is a good start in creating formal policies and procedures by providing an overview of the functions of the branch, but it does not establish certain specific procedures essential to the investigative work. For example, the complaint section provides information in areas such as complaint form completion, a description of the investigative process, the purpose of the settlement conference, and the administrative hearing format; however, it lacks specific procedures for calculating settlement amounts. In addition, although it provides a few procedures in the consignment section, the investigator's manual does not address some of the

situations encountered by the branch, such as determining an average market price to be used when the commission merchant has not provided an account of sales from the buyer for reconsignment transactions.

***Resolving Complicated Complaints
Can Require Extensive and
Questionable Use of Resources***

Investigating and attempting to settle complicated complaints involving the calculation of settlement amounts can require an extensive amount of time for the branch's staff. In reviewing some of these complaints, we noted many volumes of investigation work papers prepared and reviewed by several branch staff. Developing policies and procedures to address the wide variety of conditions encountered during these complaints and training staff in the application of these policies and procedures also will require extensive staff resources.


The branch can incur significant costs on a single complex complaint. In one case, it spent over \$67,000 on a complaint with \$37,500 in dispute.



Hundreds of staff hours can be spent on an individual complaint. In addition, we noted that one complainant alone has four open verified complaints, all of which have been submitted to the Attorney General for assistance. The branch has therefore incurred the costs of the services of the Attorney General's staff, as well as the extensive use of its own staff's time, for one individual's complaints. For one of the four open verified complaints alone, the branch estimates that it has devoted 362 supervisory and 467 investigatory hours, at an estimated cost of \$26,000. In addition, the department estimates \$8,250 in costs for the hearing officer for the complaint. Further, it has incurred \$33,000 in legal fees for the services of the Attorney General's staff as of the end of March 1996. The amount in dispute identified in the initial complaint is \$37,500.

Dealing with many such complaints can substantially divert staff resources from other work. We question the value of devoting so much of the branch's resources to individual complaints when the complainant fails to deal with licensed operators or enter into written contracts with operators. The time and money may be better spent on activities devoted to preventing violations of the code or on preparing cases for criminal or civil prosecution.


The Department Does Not Always Pursue Action for Code Violations

For the period we reviewed, the branch did not consistently impose penalties against the licensed produce dealers or processors that violated the code.

Although it devoted valuable resources to investigating the complaints discussed below and assembled sufficient documentation to justify further action against the licensees, the branch did not exercise its authority to ensure that its efforts resulted in corrective action. Further, it does not have regulations that clearly define situations that would warrant further action beyond calling an administrative hearing.



The branch has not consistently imposed corrective or punitive action against non-compliant licensees.



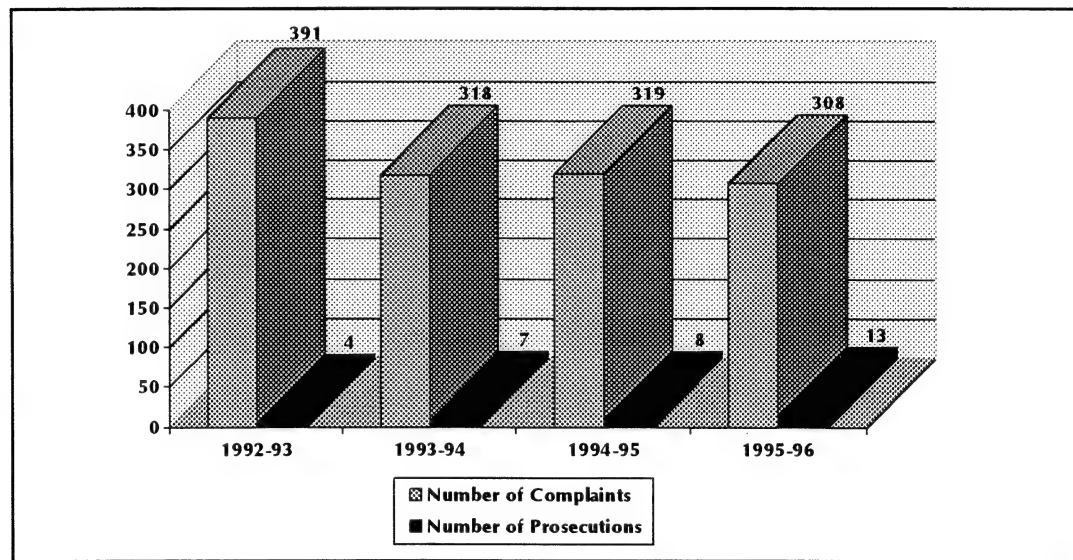
The branch has several options available when violations of the code have been identified by its audits or investigation units. Although the code does not allow it to assess and collect fines and penalties on its own, the branch does have the authority to call administrative hearings and refer cases to the appropriate legal authorities for criminal or civil action. Specifically, the code authorizes the branch to call administrative hearings to suspend or revoke licenses. Article 18 of Chapter 6 and Article 19 of Chapter 7 of the code, which establish criminal penalties, state that any misdemeanor identified in the articles is punishable by a fine ranging from a minimum of \$500 to a maximum of \$2,000, imprisonment for a maximum of one year, or both for licensed produce dealers or processors. For unlicensed operators, the punishment is a fine of not less than \$10,000, imprisonment for a maximum of one year, or both. Further, Article 19 of Chapter 6 and Article 20 of Chapter 7 of the code, which establish civil penalties, allow the branch to recover \$500 for each violation and to deposit the moneys in its Agriculture Fund. In the last two remedies, the branch is required to initiate action with either the District Attorney or superior court in which the violations occurred.

From July 1992 through March 1996, the branch received an average of 334 verified complaints per year from producers and licensees. We present this information in Figure 3. During the same period, the branch submitted 51 cases to administrative hearings. Most of these submissions (42) occurred between July 1994 and March 1996. Between July 1992 and March 1996, the branch referred 32 cases to outside authorities for criminal prosecution of violations noted. We present this information in Figure 3. Of the 32 cases, 28 were prosecutions of unlicensed operators for which the branch also requested

recovery of its costs. We found one instance in which the branch exercised its authority to refer a case to the superior court to recover civil penalties.


Figure 3

***Complaint Files Opened and Cases
Referred to Outside Authorities
Between July 1992 and March 1996***




Source: Market Enforcement Branch Complaint and Prosecution Logs, July 1992 through March 1996.

The branch prepares an investigative report at the conclusion of its examination of processors' and produce dealers' records that identifies the number of violations noted during its investigation. According to the branch chief, the branch has an informal policy: If the produce dealer or processor has satisfied the debt related to the verified complaint, either the branch will require the produce dealer or processor to submit a corrective action plan, or it will place a letter of reprimand in the respondent's license file. However, if the produce dealer or processor has not satisfied his or her debt to the producer, the branch will proceed with an administrative hearing to either suspend or revoke the produce dealer's or processor's license or to affix other conditional and probationary orders on the license. Further, although most cases submitted for prosecution relate to unlicensed activities, the branch lacks regulations that clearly define situations warranting further action, such as those allowed under the code.




In 8 of the 44 complaints we reviewed, the branch did not pursue administrative, criminal, or civil action against respondents who violated the law.




Of the 44 cases reviewed, we found the following eight instances in which the branch did not pursue administrative, criminal, or civil action against respondents after it determined that violations had occurred:

- In one instance, the producer rejected the settlement amount calculated by the branch and indicated that he would sue in civil court to recover moneys due from the produce dealer. Among the cited violations was the respondent's failure to pay the full amount realized from the sale, which is a violation of the code, Chapter 7, Section 56603. Although the branch cited the violation, it closed the case, stating that the settlement amount offered by the respondent was reasonable. However, the code requires the branch to call an administrative hearing when a settlement cannot be reached. Further, the branch took no action to initiate criminal or civil proceedings in accordance with the code. According to Chapter 7, Sections 56631 and 56652, of the code, the respondent could have been fined an amount ranging from \$500 to \$2,000, been imprisoned, been both fined and imprisoned, or held liable civilly for \$500. The produce dealer is licensed and continues to market farm products.
- In another instance, the produce dealer surrendered his license and advised the branch he would no longer market farm products. Therefore, an administrative hearing was not required to revoke the license. However, the branch took no action to initiate criminal or civil proceedings in accordance with the code. The respondent failed to pay for farm products purchased and received within the time and manner required, which is a violation of the code, Section 56603. According to the code, the respondent could have been fined an amount ranging from \$500 to \$2,000, been imprisoned, been both fined and imprisoned, or held liable civilly for \$500.
- We noted 3 cases in which the producers either refused or did not respond to the settlement amount offered by the branch. The branch identified numerous violations, ranging from 5 to 11, in its investigation reports for the 3 cases. Of the three produce dealers involved, two surrendered their licenses. Therefore, administrative hearings were not required to revoke the licenses. For the remaining produce dealer, the branch is preparing for the administrative hearing with the assistance of the Attorney General; however, this produce dealer remains licensed and continues to market

farm products. Again, in these cases, the branch did not initiate criminal or civil proceedings in accordance with the code.



For two complaints, the branch called administrative hearings to revoke the respondents' licenses, but did not pursue criminal or civil actions.



- We found 2 cases in which the branch called administrative hearings to revoke the produce dealers' licenses; however, again, in each case, the branch did not initiate criminal or civil proceedings in accordance with the code. The respondents failed to pay for farm products purchased and received within the time and manner required, which is a violation of the code, Section 56603. According to the code, the respondents could have been fined an amount ranging from \$500 to \$2,000, been imprisoned, been both fined and imprisoned, or held liable civilly for \$500.
- Finally, in another case, we found that the produce dealer refused to attend the settlement conference and that, as a result, the branch did not effect a settlement and the producer did not receive payment. Instead, the produce dealer allowed his license to lapse before the verified complaint. As a result, the branch did not need to call an administrative hearing. The branch closed the complaint, stating that no action could be taken against the entity that no longer had a license. Although the investigative report did not identify these actions as violations, the code considers the failure to make a settlement on the sales in the manner required by the code and the breach of contract to be violations. The branch has taken no action to initiate criminal or civil proceedings in accordance with the code, and it has allowed him to continue marketing farm products as an agent in conjunction with his wife's principal license.

As evidenced by the number of prosecutions during the last four years, the branch initiates prosecution for unlicensed operators; however, except for one case that is under federal jurisdiction and three cases involving cash buyers, it has not initiated similar action against licensed operators. When it fails to pursue the appropriate administrative, criminal, or civil actions against the licensees who have violated the code, the branch diminishes its effectiveness in maintaining fair market practices and loses the opportunity to use the provisions of the code as a deterrent to future violations.

***A Settlement Agreement Between
Complainants and a Respondent
Inappropriately Restricted the
Branch's Enforcement Activities***

Although the code requires the branch to either arrange a settlement between the parties to a complaint or submit the complaint to an administrative hearing, it also authorizes the branch to enforce compliance with the code by turning violators over for criminal or civil prosecution. The settlement and enforcement roles are distinct and independent under the law. Settlement agreements are reached between the complainant and respondent, with the branch acting as facilitator, and their purpose is to establish amounts owed and a schedule for payment. Enforcement activities, on the other hand, involve the branch and the respondent and have as their purpose the punishment of respondents who have violated the code.

—◆—
*As part of a settlement,
the branch agreed not to
take any further action
against a licensee even
though it had knowledge
that hundreds of
additional producers
had been affected.*
—◆—

In one complaint we reviewed, the branch inappropriately arranged a settlement agreement that contained a provision precluding the branch from taking any additional action against the respondent for activities related to the year in dispute. Thus, the branch allowed itself to be party to an agreement that should have been restricted to the complainant and respondent. The negative effect of this agreement was particularly significant because the respondent was accused of failing to pay in transactions involving hundreds of producers, but fewer than 50 of the producers were party to the settlement. When the branch agreed not to take further action against the respondent, it deprived the remaining producers of their right to the branch's assistance.

***The Branch Does Not Provide
Written Notification to Complainants
About Administrative Hearings***

The branch does not provide written notification to a complainant that an administrative hearing will be called in the event the branch is unable to negotiate a settlement of its complaint. Instead, according to the branch chief, investigators and auditors are to provide the notification orally. However, a formal policy of written notification would ensure that complainants actually receive notice of the hearing.


When we discussed this issue with him, the branch chief stated that the branch is drafting a new statement of understanding to provide to complainants when they file complaints with the

branch. The purpose of the statement of understanding is to clarify for the complainants the branch's role and powers in the complaint process. We believe that the statement of understanding also would be a good vehicle for notifying complainants in writing that hearings will be called if settlements are not reached.


The Branch Lacks Procedures for Interim Corrective Action

The branch has not established procedures to ensure that, when administrative hearings are delayed, produce dealers and processors take action to correct their practices that violate the code.

The secretary of the department is required to call administrative hearings when she fails to effect a settlement. Between July 1992 and April 1996, the branch called 51 hearings. As of April 1996, the hearing officer had rendered decisions on 36 of the 51 hearings. On an average, the branch receives the hearing officer's decision within a reasonable period, approximately 115 days from the commencement of the hearing.



When an administrative hearing was delayed on a complaint with numerous code violations, the branch did not take interim action to ensure the respondent corrected its practices.



The administrative hearing for one case that we reviewed was substantially delayed, but the branch took no action to ensure that the produce dealer discontinued its practices that violated the code. The investigator's report for the case, dated March 1995, stated that the produce dealer had committed 11 code violations and recommended that the case proceed to an administrative hearing. In June 1995, the branch referred the case to the Attorney General because the complainant was threatening branch employees. Because the branch referred the case, it discontinued any further action against the produce dealer's license, stating that no action can be taken until an administrative hearing has been called. As of May 1996, approximately 14 months after the investigative report date, an administrative hearing had not been called for the case; however, the branch is preparing for an administrative hearing to suspend or revoke the produce dealer's license, with the assistance of the Attorney General. The branch's position, supported by the Attorney General, is that the basic tenets of constitutional right to due process require an administrative hearing before the license revocation or suspension. However, Sections 56191(b) and 56532 of the code allow the branch either to deny the renewal of the produce dealer's license or to suspend or revoke the license and establish no clear

requirement for an administrative hearing. The branch has not taken the steps to recommend an amendment to the law to bring it into conformity with constitutional law.

In those cases in which an administrative hearing is delayed because of extenuating circumstances, to prevent the licensee from continuing its practices in violation of the code and escaping disciplinary actions for the violations, the branch should establish interim procedures for corrective action. For example, the produce dealer could be required to submit a corrective action plan, and the branch would monitor its activities on a periodic basis.

Conclusion

Although the branch is often able to effect a satisfactory and efficient resolution of complaints, it does not always calculate settlement amounts accurately or consistently. In five of the ten cases in which the branch reconstructed the transactions in its attempt to effect a settlement, the branch did not document its method for calculating or obtain sufficient documentation to support costs allowed, calculate the amount correctly, or use a consistent methodology to calculate the settlement amount. The deficiencies arose from the insufficient technical training that the branch provides its investigative staff in the areas of accounting, auditing, and marketing practices of the agricultural industry and its lack of formalized policies and procedures. Finally, we determined that the branch inappropriately deducted advances from the proceeds of a grower.

Settling a complicated complaint involving the calculation of settlement amounts can require an extensive amount of the branch's time and resources. For one complaint alone, the department has incurred approximately \$34,250 in staff costs and \$33,000 in legal fees for the Attorney General's staff.

The branch does not always pursue punitive action against licensed produce dealers and processors who have violated the code. In 8 of the 44 complaints we reviewed, the branch did not pursue administrative, criminal, or civil action against respondents even though it identified violations. The branch does not have regulations that clearly define those situations that would warrant further action, such as the criminal or civil remedies allowed under the code.

The branch does not provide complainants with written notification that an administrative hearing will be called if a settlement cannot be reached. In addition, we noted one

instance in which an administrative hearing was not held promptly, and, as a result, the branch took no further action against the licensee to address the violations identified in its investigative report.

We noted one settlement agreement that inappropriately restricted the branch's enforcement activities.

Recommendations

To improve its processing of complaints and take more forceful action against produce dealers and processors who violate the code, the branch should do the following:

- To assist its investigators in the calculation of settlement amounts for consignment transactions, the branch should provide technical training in areas of accounting, auditing, and marketing practices of the agricultural industry. Further, it should formally adopt policies and procedures related to the calculation of settlements and continue developing the investigator's manual.
- In deducting advances from the producer's final sale, the branch should deduct only advances authorized by a written agreement. Further, it should obtain an opinion from the Attorney General to clarify which advances the branch may deduct.
- The branch should establish and enforce regulations that define those situations justifying proceeding with criminal or civil remedies for violations of the code.
- The branch should ensure that settlement agreements do not have any provisions that would preclude the branch from carrying out its enforcement activities.
- The branch should establish limits on the amount of resources it devotes to settling individual complaints. If it exhausts this limit on the resources without being able to assess all the transactions associated with the verified complaint, the branch should indicate clearly in its investigative report the status of the work and nature of the findings. This information should provide a sufficient basis for the complainant's decision to settle or pursue further action against the respondent. The branch should consider seeking legislation that would limit the number of complaints it will investigate for a single complainant,

especially if the complainant does not enter into written contracts with operators or fails to deal with licensed operators.

- The branch should establish interim procedures to address the licensee's violation of the code when there are delays in calling an administrative hearing.
- The branch should recommend an amendment to Sections 56191(b) and 56532 of the code to bring them into conformity with the constitutional law. These sections currently establish no clear requirement for an administrative hearing before the denial, suspension, or revocation of a license.
- The branch should provide formal, written notification to complainants that an administrative hearing will be called if it fails to effect a settlement.
- The branch should finalize the statement of understanding to be provided to all complainants when they file a complaint. The statement of understanding should clarify the roles of both the complainant and the branch, as well as the authority of the branch in the complaint process. Further, the branch should prepare a similar document for the respondents in the complaints.

To improve the enforcement of action against violators of the code, the Legislature should amend the code to allow the department to assess and collect fines and penalties for code violations.

Chapter 3

The Farm Products Trust Fund Does Not Provide Sufficient Payment Protection

Chapter Summary

The Farm Products Trust Fund (trust fund) provides inadequate payment protection to producers and licensees who have not received full compensation for farm products delivered to processors or dealers. Because of the trust fund's limited resources, successful claimants against the resources of the trust fund receive, on average, only 11 percent of amounts due them. In addition, because of the extensive procedures required before trust fund payments can be issued, claimants may have a long wait for their moneys.

The California Department of Food and Agriculture (department) has considered various alternatives to address these deficiencies in payment protection, including seeking legislation to raise the licensing fees that support the trust fund or to establish secured creditor status for claimants who have not received full compensation for their farm products. However, the department has not yet ensured that the trust fund deficiencies are corrected.

Background

Established by Chapter 876 of the Statutes of 1977, the trust fund provides protection to producers and licensees from the failure of processors or produce dealers to pay for farm products delivered to them. Producers can file claims with the trust fund for partial compensation for their losses resulting from the failure of licensed produce dealers or processors to pay. Principal licensees can file claims with the trust fund against other licensees who have failed to pay them. Until the creation of the trust fund, mandatory bonding of licensees served to provide some protection against failures to pay. However, with bonding limited to \$4,000 for dealers and \$5,000 for processors, protection was minimal.

The source of funding for payments from the trust fund is the fee assessed each licensee annually. Licensees requesting a conjunctive license, which allows them to operate in a dual role, such as produce dealer and processor, are assessed a


\$250 fee, and all others are assessed \$125. The branch uses these fees only to pay claimants against the trust fund, with the costs of administering the trust fund incurred by the Agriculture Fund. Claimants receive trust fund moneys only after they have demonstrated that they have exhausted other methods of recovery, including administrative hearings and bankruptcy filings.

The Market Enforcement Branch (branch) orders a four-year suspension of the license of any respondent who has had trust fund moneys paid to its claimants. Between July 1995 and April 1996, the branch paid 898 claimants \$1,329,701 for claims against 82 licensees.

Trust Fund Payments Are Too Small and Occur Too Slowly

In its current form, the trust fund provides only minimal protection for claimants' interests because payments are too small, averaging 11 percent of amounts claimed. The process for determining the number of claimants and how much is owed to each claimant can also be too slow.

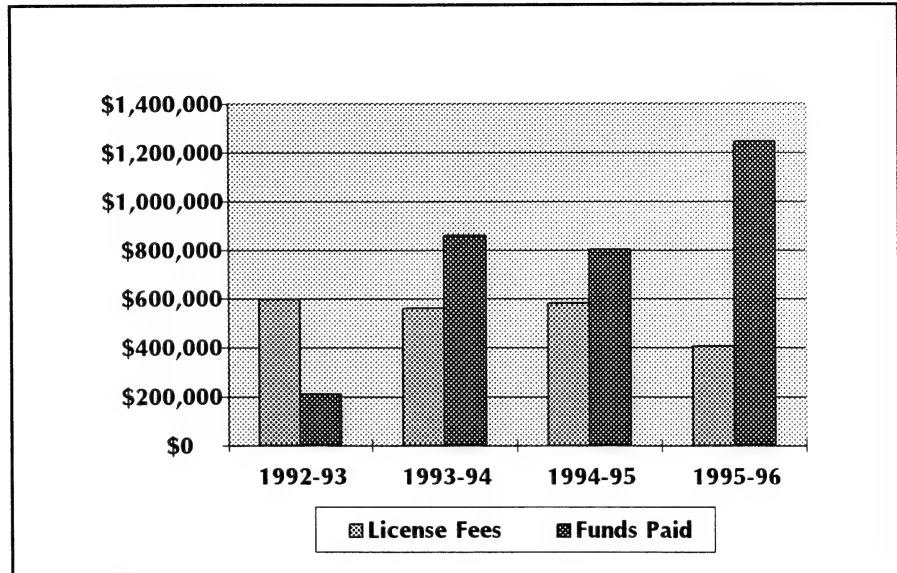
Division 20, Chapter 7.5, Section 56708, of the Food and Agricultural Code (code) allows the department to make trust fund payments of up to 50 percent of any claim, with a maximum of \$50,000 for all claimants against any one licensee. The \$50,000 is an absolute limit on the amount payable for claims against a single licensee, regardless of the number of claimants. Thus, under current law, if 50 percent of one individual's claim is \$50,000, the individual would be able to collect the entire \$50,000. On the other hand, if there are 25 legitimate claimants, each would receive only his or her proportionate share of the \$50,000.


With \$1 million available
to pay an estimated
\$3.8 million in current
claims, the trust fund
faces insolvency.

The branch's current policy further limits the amount payable to claimants to 30 percent of a claim, up to \$25,000 for all claimants. The department enacted this policy in July 1988 as a means of preserving the solvency of the trust fund. Even with this stricter limitation on individual claims, the trust fund has paid out more annually than it has taken in since fiscal year 1993-94, as illustrated in Figure 4. As of April 1996, the department's records show that the trust fund had \$1.04 million available and an estimated payout totaling \$3.8 million. This financial status indicates that the solvency of the fund is again threatened.

Figure 4

***Trust Fund Revenues and Disbursements
Fiscal Years 1992-93 Through 1995-96***



Note: The 1995-96 fiscal year column reflects activity through March 1996.

The branch's policy of paying less from the trust fund than the law allows has been challenged and determined to be legal.

The branch's policy of limiting claims to 30 percent of an individual claim and \$25,000 total has withstood legal challenge. In April 1995, the California Court of Appeal, First Appellate District, concluded that the statutes, although ambiguous, permit the department to limit payments to less than that allowed under the law as long as the department treats all claims consistently. Our review of selected payments from the trust fund in fiscal year 1994-95 indicated that the department was consistent in its treatment of claims.

As Table 1 illustrates, actual payments to claimants since calendar year 1993 have averaged only 11 percent of total claims. Although these payments are better than none at all for the claimants, they do not represent significant compensation for losses in many cases.

Table 1***Trust Fund Payments as a
Percentage of Amounts Claimed***

Year	Total Number of Claimants	Total Amount Claimed	Total Trust Fund Payout	Percentage of Amounts Claimed Paid Out
1993	394	\$ 4,204,197	\$ 517,995	12%
1994	561	9,547,399	1,020,761	11
1995	505	6,275,257	893,686	14
1996	558	9,370,082	748,395	8
Totals	2,018	\$29,396,935	\$3,180,797	11%

Source: Market Enforcement Branch Trust Fund Files, January 1993 through April 1996.

*Claimants wait an
average of 17 months
before receiving trust
fund payments.*

Compounding the problem of limited payments is the delay in receipt of those payments. Under the best of circumstances, meeting code requirements can result in long delays between the time a claimant files for payment from the trust fund and the time he or she actually receives the payment. Before a payment can be made from the trust fund, the law requires the branch to exercise due diligence in notifying all the respondents' creditors of their right to submit a claim against the trust fund. To meet this legal requirement, the branch typically obtains a list of creditors in addition to the original claimant from either the respondent or the bankruptcy court, if applicable, and then sends each creditor a notification. In addition, the branch must ensure that claimants made other attempts to resolve claims before trust fund moneys can be disbursed. For example, the claimant could attempt to establish a payment agreement with the respondent or seek arbitration. If the respondent entered bankruptcy, the branch also must ensure that bankruptcy proceedings are complete before making trust fund payments.


Additional delays occur when the department does not process claims as promptly as possible. For example, it recently discovered approximately 150 claims, filed as early as 1986, in its El Monte district office that it had either temporarily lost or forgotten. Although the department has organized a task force that has processed approximately 120 of these claims and is continuing to work on the remaining claims, the processing has been unnecessarily delayed.

For 18 payments between July 1994 and June 1995 that we reviewed, the span of time between filing and payment ranged from 2 months to 59 months and averaged 17 months.


Questions About the Value of the Trust Fund Have Arisen Periodically

Concern about the usefulness and fiscal viability of the trust fund has existed since shortly after its establishment. In 1985, the Market Enforcement Advisory Committee (advisory committee) noted the potential for trust fund resources to be exhausted after the payment of then-current and future cases. In 1987, a subcommittee of the advisory committee evaluated the effectiveness of the trust fund, concluding that the maximum payments represented little compensation under current economic conditions.

A wide range of solutions to the problems with the trust fund has been proposed by the advisory committee. Some suggestions, such as the implemented reduction to the maximum payable to claimants discussed above, maintain the basic procedures for the fund established in law and only modify existing practices to bring about desired changes. Included in this category are recommendations to preserve the solvency of the trust fund by amending the law to raise licensing fees and to establish lower limits on the dollar amount of claims to be considered for trust fund reimbursement and actual payments from the trust fund.



Proposed solutions for the trust fund's problems include raising the fees that support it or eliminating it altogether.



Other recommendations are more substantive, requiring major changes in the law. Most recently, the Market Enforcement Policy Review Committee (policy review committee), in its draft report to the secretary of the department, recommended that the current trust fund be eliminated, allowing for pro rata payments of amounts remaining in the trust fund to eligible claimants, and be replaced with a trust concept similar to that established under federal law. According to the proposal, this trust concept would provide eligible producers and licensees greater legal protection, giving them priority interest up to the net amounts due them in proceeds from the sale of covered farm products in all instances and specifically in the event of a respondent's bankruptcy or business failure. Currently, the trust fund provisions of the code do not establish complainants as secured creditors in bankruptcy cases. The recommendation further would allow producers of commodities not covered under the trust concept to be eligible for lien protection. Thus, under the trust concept, payment security would not be

established through trust fund disbursements administered by the department. Instead, it would derive from the complainants' secured creditor status and lien protection.

The advantages of the trust concept include the potential for greater compensation to complainants, who could receive the entire amount owed them. In addition, a complainant with priority interest in the proceeds in the sale of its farm products should receive payments more quickly, avoiding lengthy and costly bankruptcy proceedings and the current administrative procedures for the trust fund.

As of May 1996, the secretary had not taken any formal action on these recommendations from the policy review committee.

Conclusion

As it is currently constituted, the trust fund does not provide adequate payment protection to claimants in an efficient and cost-effective way. After waiting an average of 17 months for payment, claimants receive, on average, only 11 percent of amounts due them. The department has not taken adequate steps to ensure that it addresses these deficiencies in payment protection.

Recommendations

The department should assess what changes in law or policy related to the trust fund will most effectively and efficiently provide the greatest benefits to claimants. One option is to seek legislation to raise the licensing fees that support the trust fund so that more money will be available for payments. Another option is to seek legislation that eliminates the trust fund and substitutes greater legal protection, in the form of lien protection and secured creditor status that provides priority interest in the proceeds from the sale of farm products, to producers or licensees who have not received full compensation for farm products delivered. The department also should consider any other options that appropriately eliminate the deficiencies in payment protection and submit the most effective and efficient course of action for legislative consideration.

We conducted this review under the authority vested in the state auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

A handwritten signature in black ink, reading "Kurt R. Sjoberg". The signature is fluid and cursive, with the first name "Kurt" and last name "Sjoberg" clearly legible.

KURT R. SJOBERG
State Auditor

Date: July 2, 1996

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Appendix

Glossary

The following terms are used in Division 20, Chapters 6, 7, and 7.5 of the California Food and Agricultural Code (code).

Agent—For processors of farm products, an “agent” is any person who, on behalf of any processor, contracts for or solicits any farm product from a producer of the farm product, or who negotiates the purchase of any farm product on behalf of any processor. For produce dealers, “agent” means any person who, on behalf of any licensee, receives on consignment, contracts for, or solicits for sale on commission, any farm product from a licensee or producer of such product, or who negotiates the consignment or purchase of any farm product on behalf of any licensee.

Broker—“Broker” means any person who negotiates the purchase or sale of any farm product. A broker may not, however, handle either the farm product that is involved or the proceeds of a sale.

Cash Buyer—“Cash buyer” means any person who obtains title to, obtains possession or control of, or buys or agrees to buy any farm product from a licensee or a producer by paying to the seller the full agreed price in cash at the time of obtaining possession or control, or at the time of contracting for title to, or possession or control of any farm product.

Commission Merchant—“Commission merchant” means any person:

- a) Who receives on consignment or solicits any farm product from a licensee or producer of the product.
- b) Who accepts any farm product in trust from a licensee or the producer of the product for purposes of sale.
- c) Who sells any farm product on commission.
- d) Who handles any farm product in any way from the account of or as an agent of the consignor of the product. Any person who accepts a farm product from a licensee or the

producer of such product for the purpose of sale or resale is a commission merchant, unless the person has bought, or agreed to buy, the farm product by a contract that designates the price to be paid to the seller.

Consignor—“Consignor” includes any person who ships or delivers to any commission merchant or dealer any farm product for handling, sale, or resale.

Dealer—“Dealer” means any person who obtains title to, or possession, control, or delivery of, any farm product from a licensee or producer at a designated price for the purpose of resale, or who buys or agrees to buy any farm product from a licensee or the producer of the farm product at a designated price.

Farm Product—For processors of farm products, “farm product” includes every agricultural, horticultural, viticultural, or vegetable product of the soil, honey and beeswax, oilseeds, poultry, poultry product, livestock product, and livestock for immediate slaughter. It does not include timber or any timber product or milk or any milk product. For produce dealers, farm product includes every agricultural, horticultural, viticultural, or vegetable product of the soil, poultry, poultry product, livestock product, and livestock not for immediate slaughter, bees and apiary products, hay, dried beans, honey, and cut flowers. It does not, however, include any timber or timber product or any milk or milk product which is subject to the licensing and bonding provisions of Chapter 2, Part 3, Division 21 of the code.

Licensee—A “licensee” is any person licensed under the provisions of these chapters as a processor, cash buying processor, broker, cash buyer, commission merchant, or dealer.

Processor—“Processor” means any person who is engaged in the business of processing or manufacturing any farm product, who solicits, buys, contracts to buy, or otherwise takes title to, or possession or control of, any farm product from the producer of the farm product for the purpose of processing or manufacturing it and selling, reselling, or redelivering it in any dried, canned, extracted, fermented, distilled, frozen, eviscerated, or other preserved or processed form. It does not, however, include a retail merchant who has a fixed or established place of business in this state and does not sell at wholesale any farm product that is processed or manufactured by him or her.

Producer—“Producer” means any person who engages in the business of growing or producing any farm product.

DEPARTMENT OF FOOD AND AGRICULTURE



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June 24, 1996

Kurt Sjoberg, State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

Generally, the Department of Food & Agriculture (Department) agrees with the analysis and recommendations contained in this report concerning its market enforcement program. The report has identified concerns with some of the program's systems in the areas of licensing, complaint handling and enforcement. Where there have been improvements made or efforts are underway to correct deficiencies the report has so indicated. The report has also provided guidance regarding certain poor business practices in the agricultural industry, such as a lack of written contracts, that can make resolution of complaints difficult. Finally, the report has suggested areas that may require legislative reform and areas where it may be prudent to seek the formal opinion of the Attorney General to assist in clarifying complicated issues such as waivers. The Department's response will not address in detail all the points presented in this report, instead comments will be made regarding the issues discussed in the report categories: (1) licensing; (2) complaint handling and enforcement; and (3) the Farm Products Trust Fund.

LICENSING

As noted in the introduction to the report, the laws for market enforcement were enacted between 1928 and 1935. Agriculture as well as every other industry has experienced tremendous change since these laws were enacted. The resources dedicated to supporting the activities of this program, slightly more than \$3 million dollars annually, comprise only 1.7 percent of the total budget for the Department. A review of the program's internal controls did not reveal any material weakness concerning the management of its cash receipts and cash disbursements.

The report noted that the licensing program is intended to help maintain the orderliness of the agricultural marketplace by ensuring that successful applicants can meet their financial responsibilities. This perception that the program can somehow ensure the financial viability of a licensee is problematic; the licensing requirement only specifies a financial balance sheet be submitted for a snapshot in time unless there is evidence of instability. Concerns were expressed about the lack of clear criteria for processing license applications which resulted in errors. It was noted that the branch had recently developed an Investigator's Manual, however, it did not provide the level of specificity needed to ensure that licenses were issued properly.

We agree that it is important to develop a comprehensive procedures manual targeted for licensing practices. It is important to ensure that the staff responsible for this activity be provided with the necessary tools for assessing new and renewal license applications. Limited resources have impacted this effort. The branch is committed to completing a licensing procedural manual as soon as possible.

Adequate communication to licensees and producers of their rights and responsibilities under these laws was listed as an important part of an effective licensing program. The report described the efforts that the program had made to inform current or potential licensees and producers through outreach industry meetings and sponsorship of a booth at farm shows. Advisory notices were established to inform producers of licensees who had complaints filed against them. Additionally, the report discussed the proactive steps the program had taken to ensure licensees were paying the correct amounts by conducting spot audits. This activity resulted in increased revenues to the program.

The report analyzed the database system used by the program to maintain its licensing information. Several areas of deficiencies were identified in the report. The Department was aware of this matter. A report prepared by the Division of Marketing Services also had identified weaknesses in the system in an earlier report.

We agree that the current database system is inadequate and requires substantial change. We acknowledge that we have taken steps to improve this situation, however, much work remains to be done. This is an important area to remedy as improvements here will enhance the effectiveness and efficiency of the licensing process as a whole. Available revenue will be a factor in this effort.

The issue of waivers was included under the licensing section of the report. Concern was expressed that sample forms provided by the program during the licensing process may not be legally adequate. The report recommends requesting an opinion of the Attorney General to assist the program regarding waivers. We agree that this important issue needs to be addressed either by department counsel or the Attorney General.

COMPLAINT HANDLING AND ENFORCEMENT

The report states that in carrying out its responsibilities to receive and investigate complaints, the program is often successful in attempting to effectuate a settlement between the parties. Attempting to effectuate a settlement is a statutory requirement. This complaint handling and dispute resolution process provides an alternative to court actions. It is intended to serve the purpose of saving legal fees and deterring unfair business practices. The report finds that the program appropriately handles claims that do not involve the calculation of settlement amounts and claims involving the Farm Products Trust Fund. The report concludes that in these cases the program provides an important service to the agricultural community.

In cases where settlement amounts require extensive calculations, the report finds that investigative and audit staff lack adequate policies, procedures and training for calculating settlement amounts. Moreover, the report finds that extensive time is expended to investigate complicated complaints involving settlement calculations which inappropriately restricts enforcement activities. This negatively impacts the program's limited resources and is further exacerbated by the fact that poor business practices in the agricultural community can make resolution of these claims difficult. Often, there are no written contracts, inadequate records, and failure by producers to deal only with licensed entities. This puts the program in the position of trying to assist complainants who have not taken adequate steps to protect their own interests.

We agree that we need to continue to develop the investigators' manual and provide technical training for staff. We need to adopt formal policies and procedures in identified areas. An audit manual has been prepared in draft form and needs to be finalized. The complaints described in detail in the report are all consignment cases and often contain complicated issues of law and fact. We agree that it would be desirable to set limits on the amount of resources we devote to settling individual complaints and that legislation may be needed to

Mr. Kurt Sjoberg, State Auditor
June 24, 1996
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limit the number of claims per complainant or preclude service if there is no written contract.

We agree that regulations would be beneficial to clarify and support the enforcement process and the administrative hearing process. Legislation may be necessary to provide for administrative penalties to improve the enforcement ability of the Department. Additionally, new laws may be needed to clarify the hearing process regarding license revocation and the status of a license pending a hearing.

FARM PRODUCTS TRUST FUND

The Department agrees with the entirety of this section and corresponding recommendations.

In conclusion the Department takes its responsibilities seriously and will address the recommendations made in this report. The Department will focus on continuing to enhance the effectiveness of this program and assessing areas where fundamental change is needed. The Legislature has initiated reforms based upon work that has been done by the policy review committee and the advisory committee. We would like to thank the staff of the Bureau of State Audits for their professionalism in accomplishing this report.

Sincerely,

A handwritten signature in cursive script, reading "Carol D. Chesbrough".

Carol D. Chesbrough, Director
Division of Marketing Services

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps